IN THE HIGH COURT OF JUDICATURE AT BOMBAY

O. O. C. J.

COMPANY PETITION NO.288 OF 2007

Elpro International Limited. ...Petitioner.

.....

Mr. D.J. Khambata with Mr. Simil Purohit and Mr. Tapan Deshpande i/b. Amarchand & Mangaldas for the Petitioner.
Mr.P. N. Mody with Mr.Sagar Divekar and Mr. Jaideep Singh i/b. Wadia Ghandy for the Respondent.

.....

CORAM : DR. D.Y. CHANDRACHUD, J.

June 22, 2007.

ORAL JUDGMENT:

The Petition before the Court has been instituted under the provisions of Section 101 of the Companies' Act, 1956 and seeks an order of the Court for a reduction of the capital of the Petitioner. The Petitioner was incorporated on 27th July 1962 and is a Public Limited Company. The main objects of the Petitioner as provided in its Memorandum of Association, inter alia, include carrying on business of electrical and electronic appliances, apparatus and equipment. The Company was engaged in the business of manufacturing lightening arresters and isolators. In pursuance of the sale of the Isolator

Division of the Petitioner Company located at Hyderabad, the present business consists of the manufacture of lightening arresters. The Company was initially incorporated with an authorised share capital of Rs.5 crores divided into 5 lakh equity shares of Rs.100/- each. The present authorised share capital is Rs.5 crores divided into 50 lakh equity shares each of Rs.10/-. The equity shares of the Company are listed on the Bombay Stock Exchange (BSE) and Pune Stock Exchange. The issued and paid up share capital of the Company as on 31st March 2006 is Rs.3,55,66,770/- divided into 35,56,677 shares each of Rs.10/-. Upon the proposed reduction, the issued and paid up share capital of the Petitioner shall be Rs.2,66,75,080/-. The Company seeks to reduce its share capital by an amount of Rs.88,91,690/- constituting 25% of its issued and paid up share capital.

2. The principal reasons underlying the proposed reduction of capital have been spelt out in paragraph 11 of the petition thus :

> "(a) The Petitioner Company has sold its Isolator Division located in Hyderabad, as approved by an ordinary resolution of the shareholders of the Petitioner Company by way of a postal ballot process, due to the severe

competition faced by it in terms of input costs and margins, both in domestic and international markets. Subsequent to such sale, the residual business of the Petitioner Company will be the manufacture of lightening arresters.

(b) The sale of the Isolator Division has generated surplus funds for the Petitioner Company. As a result, the Petitioner Company has more capital resources than it can profitably employ and the capital is in surplus to its needs. The Petitioner Company may face serious cash flow difficulties due to unavailable business, which would also negatively impact its cash reserves. This has given rise to the need to readjust the relation between capital and assets and to accurately and fairly reflect the liabilities and assets of the Petitioner Company in its books of account. The Petitioner company evaluated the effects of such over capitalisation upon the Petitioner Company's functioning and carefully examined the following options available to the Petitioner Company;

(i) Growth of Lightening Arrester Division – The Lightening Arrester Division of the Petitioner Company located at Pune is a low yield business and is currently operating at a break even level. Based on the Petitioner Company's projections in relation to the profitability, asset and liability position and cash flow requirements of the Lightening Arrester Division for the next three to five years, the Lightening Arrestor Division is expected to have a limited fund requirement which would be met through its internal accrual and would not require the infusion of any additional capital.

(ii) Acquisition of a Company in Similar Business – Based on the Petitioner Company's analysis of market conditions, it has been noted that the current valuation of companies engaged in the business of manufacturing isolators and lightening arresters is significantly high. In view of the foregoing, the Petitioner Company does not

intend to acquire any manufacturing business at such high value and risk the funds of its shareholders.

(iii) Diversification of Business – Since its incorporation in the year 1962, the Petitioner Company has been mainly engaged in the manufacture of lightening arrestors and since 1994 the Petitioner Company also been (sic) to engage its manufacturing competencies in the production and manufacture of equipments utilized by the power sector, the Petitioner Company has concluded that entering into a new area of manufacture would not lead to effective utilization of funds."

3. The Board of Directors of the Petitioner had in a meeting held on 27th January 2006, passed a resolution in respect of the reduction of the issued and paid up capital of the Company. As aforesaid the Petitioner proposes to extinguish and cancel 8,89,169 shares held by shareholders constituting 25% of the issued and paid up share capital and returning capital to such shareholders at Rs.183/- per equity share of Rs.10/- each so cancelled and extinguished in accordance with Section 100 of the Companies' Act, 1956.

4. The market price per share of the Company on the Bombay Stock Exchange at the point of time when the aforesaid resolution

was passed by the Board of Directors was Rs. 172.25. On 27th January 2006 notices were sent to all the shareholders of the proposed resolution by postal ballot and shareholders were asked either to vote in favour of or against the resolution. The scheme propounded that the reduction of share capital would take place from amongst such shareholders who either vote in favour of the resolution or do not object to the resolution. In other words, the scheme provides an option whereby the shares of such shareholders who voted against the resolution would remain untouched.

5. The result of the postal ballot was as follows :

-(i) The total number of postal ballot notices sent out – 3859;

(ii) The total number of valid responses received – 136 which represented 25,93,684 shares of the Company;

(iii) Total invalid responses received – 1;

(iv) Total responses expressly in favour of the resolution – 112 representing 25,81,017 shares of the Company equivalent to 99.5% of the voted shares;

(v) Total responses expressly against the resolution – 24 representing 12,667 shares equivalent to 0.5% of the voted shares. The proposed scheme of reduction was approved by 95.76% in number and 99.62% in value of the creditors of the Company. The resolution was duly carried by the requisite majority, as statutorily prescribed.

6. In accordance with the scheme as approved by the shareholders, the reduction of 25% of the issued and paid up capital is to take place from amongst 3835 shareholders which includes 112 shareholders who voted for the resolution and 3723 shareholders who did not object to the resolution. There is a recital in the petition to the effect that the value of the shareholders would be adequately protected by extinguishing and returning share capital at Rs.183/- per equity share, which is a value determined after providing a premium of ten per cent over the prevailing market price of Rs. 166.50 per share as on 25th January 2006, the price prevalent immediately before the meeting of the Board of Directors and which would be met with from the proceeds of the sale of the Isolator Division. The

Company had appointed T.R. Chadha & Co. as external valuers to determine the value of the shares. The Company Petition contains an averment that the price at which share capital is proposed to be returned to the shareholders is the highest of the parameters taken into consideration by the valuers in preparing the weighted average value of the shares and is at a premium over the weighted average value of each share as determined by the valuers as well as the current market value of the shares as on 25th January 2006, immediately before the meeting of the Board of Directors.

7. On 25th July 2006, pursuant to the provisions of clause 24(f) of the Listing Agreement with the Stock Exchanges, the Petitioner filed a draft of the proposed petition with the Stock Exchanges where the Company is listed. The Company received a letter dated 22nd August 2006 from the Bombay Stock Exchange ("BSE") in which it was stated that the scheme of the reduction of capital should be made applicable either to all the shareholders of the Company or only to those shareholders who have furnished a positive assent to the special resolution. The Company was advised not to proceed with the

filing of the Petition in this Court until BSE granted its no objection to the same. By its letter dated 16th October 2006, the Company responded to BSE and submitted that it was permitted in law to reduce capital in any manner including, but not limited to, the method of paying off paid up share capital which is in excess of its wants. The Company submitted that a selective reduction of the share capital has been permissible in law and since it had obtained a special resolution of its shareholders approving the proposed reduction, implementation of the conditions imposed by BSE would be contrary to the terms of the resolution passed under Section 100 of the Companies' Act, 1956. In pursuance of a further request made by BSE, the Company has furnished an undertaking on 20th December 2006 stating, inter alia, that in the event that the non-promoter shareholding of the Company falls below the minimum limit prescribed by Stock Exchange Regulations upon the reduction of share capital in accordance with the proposed scheme, the promoters shall take necessary steps for meeting the immediate non-promoter holding requirement of 25% of the post-scheme paid up share capital by way of divestment of their shareholding to the extent required, to SEBI

Registered Qualified Institutional Buyers, Mutual Funds, Financial Institutions or Scheduled Banks within a period of three months from the date of the order of this Court confirming the reduction.

8. On 17th January 2007, BSE issued a letter to the Petitioner declining its permission to proceed with the scheme on the following grounds :

-(i). There was a substantial increase in the price at which the shares of the Company were trading in the past few months and the closing price of the shares on the date of the letter was Rs.322/- per share which was considerably higher than the exit price of Rs.183/- being offered to the shareholders;

-(ii) The promoters of the Company would have the benefit of realising a higher market value for the divestment of their shareholding in the light of the undertaking that they would take necessary steps for increasing non-promoter shareholding to at least 25% after the scheme was sanctioned.

9. In support of the Petition, Counsel appearing on behalf of the Petitioner submitted that (i) It is a settled principle of law that a selective reduction of capital is permissible and lawful; (ii) The Scheme in fact furnishes an exit opportunity to every small shareholder who has made a positive act of casting a ballot against the scheme; (iii) The financial position of the Company has been duly certified by the auditors and both before and after reduction as proposed, the networth of the Company would continue to be positive; (iv) 95.76% in number and 96.62% in value of the total shareholders have consented to the scheme; (v) The procedure under Section 101 (3) of the Companies' Act was dispensed with on 13th April 2007. In so far as the objection by the Stock Exchanges is concerned, it has been submitted that when the Resolution of the Board of Directors was passed on 27th January 2006, the value of the shares was Rs. 172.25 per share. Though an increase in the share price took place in December 2006 and January 2007, the Petitioner had in fact, applied for the sanction of the Stock Exchanges on 24th July 2006. The Petitioner has relied upon share price movement data of the shares of the Petitioner for the period between January 2006 to

January 2007 as quoted on the website of the BSE. That data, it has been urged, shows that on the date of the meeting of the Board (27th January 2006) the closing share price was Rs. 172.25 per share. The closing share price continued to be much lower than the offered exit price of Rs. 183/- per share on the date when the postal ballot was sent to the shareholders of the Company as well as on the date, when the results of the postal ballot were declared, that is on 23rd March 2006. On 23rd March 2006, the closing share price of BSE was Rs. 156.25. On 25th July 2006, when a draft petition was filed with the BSE for its approval under Clause 24(f) of the Listing Agreement, the closing share price on BSE was Rs. 124.45 per share. The shares of the Petitioner continued to trade on BSE at a price much below the exit price of Rs.183/- per share till the beginning of December 2006. It has been urged that the price on the date of the resolution of the Board must be regarded as the relevant price for consideration and the price that is offered was fair and reasonable. It has been urged that under clause 24(f) of the Listing Agreement, the Petition is required to be lodged with the Stock Exchanges one month prior to the date of the filing and the Stock Exchanges accordingly have been

granted a period of one month to respond to an application. On 25th August 2006, on which date the shares of the Company were trading, the price per share was Rs. 155.60. The BSE, it is urged, issued its final letter only on 17th January 2007 several months after the filing of the petition with the BSE. Increase in the shareholders price is based on market movement and may be speculative in nature and it is not necessarily reflective of an increase in the valuation of the Company. The Company has urged that the date for considering the comparable or the cut off price has to be fixed and cannot be open ended. The cut off date, it was urged, ought to be the date of the resolution of the Board.

10. At the hearing of the Company Petition, the Bombay Stock Exchange urged that out of 3859 shareholders only 137 shareholders voted in the course of the postal ballot and 3722 shareholders had not cast a ballot in the first place. The promoters hold 60% of the issued share capital, consequent upon which the resolution was a foregone conclusion. The objection of the Stock Exchanges is that the balance of the shareholders who did not cast their votes are being treated as

if they had accepted the proposed scheme. Moreover, as a result of the proposed scheme, the shareholding of the small shareholders would be wiped out in its entirety. The objection of the Stock Exchanges therefore, is that the reduction ought to be effective either (i) By affecting only those shareholders who have specifically agreed to a reduction of their capital; or (ii) By applying the reduction to all the shareholders. Counsel appearing on behalf of the Stock Exchanges concedes the position that in law, while effecting a reduction of capital, differential treatment to different shareholders is permissible. The submission, however, is that this should be done either on the basis of the positive consent of each shareholder who would be affected or in the alternative should apply across-the-board to all the shareholders.

The Law on reduction of capital:

11. The law relating to a reduction of share capital of a Company is contained in Sections 100 to 105 of the Companies' Act, 1956. Section 100 authorises a Company to reduce its share capital and lays down the procedure which is required to be followed. Sub-

Section (2) of Section 101 then provides that where the proposed reduction of share capital involves either a diminution of the liability in respect of unpaid share capital or the payment to "any shareholders" of any paid up share capital and in any other case, if the Court so directs, then the provisions which have been made thereunder shall have effect. The adoption by Parliament of the words "any shareholders" in Section 101 of the Companies' Act, 1956 indicates that a reduction of share capital need not necessarily be qua all shareholders of the Company, but can take place from one or more amongst the body of shareholders. A classification of shareholders for the purposes of effecting the reduction of capital is, therefore, not an act which is extraneous to the provisions of Section 101. The Court must give effect to the plain meaning and intendment of the provisions of Section 101. Corporate autonomy must have a wholesome recognition in law and unless the law circumscribes it by a clear provision, the Court would not read limitations where the legislature has not imposed them.

12. One of the leading decisions in England which approves a

selective reduction of capital is the decision of the House of Lords in **British and American Trustee and Finance Corporation Ltd. and Reduced Vs.John Couper.**[1] In that case, the shares of the Company were divided into ordinary shares partly paid up, and founder's shares partly paid up. The Company carried on business both in England and in the U.S., but it being found impossible to do so in both countries with advantage, it was determined that the Company should cease to carry on business in the U.S. This was carried out by a special resolution which provided that the capital should be reduced by paying off the shares (i.e. both ordinary and founder) held by American shareholders only since the capital represented thereby was in excess of the wants of the Company. Such shares and all liability thereon were to stand wholly extinguished. The House of Lords held that the prescribed majority of the shareholders of a Company is entitled to decide whether there should be a reduction of capital, and if so, in what manner and to what extent it should be carried into effect. In a concurring judgment Lord Macnaghten held thus:

"If the parties to the transaction come to the conclusion that

1 1894AC 399 (HL)

> the bargain is a fair one, why should the Court say that there is a preference on the one side or on the other? If there is nothing unfair or inequitable in the transaction, I cannot see that there is any objection to allowing a company limited by shares to extinguish some of its shares without dealing in the same manner with all other shares of the same class. There may be no inequality in the treatment of a class of shareholders, although they are not all paid in the same coin, or in coin of the same denomination."

In a separate judgment, Lord Herschelle held as follows:

> "If all the shareholders of a company were of opinion that its capital should be reduced, and that this reduction would best be effected by paying off one shareholder and cancelling the shares held by him, I cannot see anything in the Acts of 1867 and 1877 which would render it incumbent on the Court to refuse to confirm such a resolution, or which shows that it would be ultra vires to do so. ... There can be no doubt that any scheme which does not provide for uniform treatment of shareholders whose rights are similar, would be most narrowly scrutinized by the Court, and that no such scheme ought to be confirmed unless the Court has satisfied that it will not work unjustly or inequitably. But that is is quite a different thing from saying that the Court has no power to sanction it."

13. The decision of the House of Lords in the **British and American Trustee and Finance Corporation Ltd**. case was followed in England in the decisions in **Poole vs. National Bank of China**, 1907 Appeal Cases 299; in **re Thomas De la Rue & Co. Ltd. and**

Reduced, (1911) 2 Ch.361; **Westburn Sugar Refineries Ltd**., (1951) 1 All ER 991 (HL) and in **re Robert Stephen Holdings Limited**, (1968) 1 WLR 522.

14. In **Ramesh B. Desai v. Bipin Vadilal Mehta**,[2] the Supreme Court referred to the commentary in the Guide to the Companies Act by A. Ramaiya with approval which describes the decision in the **British and American Trustee and Finance Corporation Ltd**. case as the leading authority on the subject of a reduction of capital. In **Hindustan Commercial Bank Limited vs. Hindustan General Electric Corporation**,[3] the Calcutta High Court referred to the judgment of the House of Lords in the **British American Trustee** case with approval and held that the question of reducing capital is a domestic affair to be decided by the majority. The Court held that the Companies' Act, 1956 leaves it to the company to decide for itself the extent and mode of reduction and application of the moneys thereby. This is, however, subject to the confirmation of the Court, which is required for safeguarding the interests of creditors and minority

2 AIR 2006 SC 3672
3 AIR 1960 Cal 637

shareholders and seeing that it is fair, just and reasonable. A similar view was taken by the Madras High Court in **Re: Panruti Industrial company (Private) Ltd.**,[4] and more recently in **Kaashyap Radiant Systems Limited**, an unreported decision of June 17, 2006 in Company Petition 48 of 2006. After considering several decisions, including the decision of the House of Lords in **British and American Trustees,** the Madras High Court held that the question of reduction of capital is a matter of domestic concern, one for the decision of the majority of the shareholders of the Company. Since the decision for reduction is based on commercial considerations undertaken by businessmen who are in the best position to know of the necessities and interests of the Company concerned, in the absence of serious allegations as regards the bona fides of the proposed scheme, the Courts are hesitant in interfering with the view of the majority. The Court has to consider whether the interests of those members of the public who may be induced to take shares in the Company are secured and whether the reduction is fair and equitable as between different classes of shareholders. In **Panruti Industrial Company**

4 AIR 1960 Mad 537

(Private) Ltd. (supra), the Madras High Court made the following observations:

> "When exercising its discretion the court is concerned to see that the reduction is fair and equitable but it is not concerned with the motive for reduction (at para 9, page 539) ... The company however is not bound to satisfy the court that the proposals are not unfair, it is for the objectors to disclose such matters, as will stand in the way of the Court's approval. (at para 14, page 540)"

15. In a recent decision in **Reckitt Benckiser (India) Ltd.**[5] the Delhi High Court underlined the following principles which emerge from the law relating to a reduction of share capital:

> "(i) The question of reduction of share capital is treated as a matter of domestic concern, i.e. it is the decision of the majority which prevails;
>
> (ii) If a majority by special resolution decides to reduce share capital of the company, it has also the right to decide as to how this reduction should be carried into effect;
>
> (iii) While reducing the share capital the company can decide to extinguish some of its shares without dealing in the same manner as with all other shares of the same class. Consequently, it is purely a domestic matter and is to be decided as to whether each member shall have his share proportionately reduced, or whether some members shall retain their shares unreduced, the shares of others being extinguished totally, receiving a just equivalent.

5 122(2005) DLT 612

(iv) The company limited by shares is permitted to reduce its share capital in any manner, meaning thereby a selective reduction is permissible within the framework of law (see Re. Denver Hotel Co., 1893(1) Chancery Division 495).

(v) When the matter comes to the Court, before confirming the proposed reduction the Court has to be satisfied that (i) there is no unfair or inequitable transaction and (ii) all the creditors entitled to object to the reduction have either consented or been paid or secured."

The facts :

16. In the present case, the Court must first and foremost have regard to the well established position that a selective reduction of share capital is legally permissible. It is significant for the purposes of the present proceedings to note what an option of reduction accompanied by a return of capital was given in the first instance to the entire body of shareholders. The resolution, however, prescribes that the actual return of capital was to be made to such shareholders that "either assent or do not object by postal ballot to the proposed reduction". An exit opportunity was provided by the Company. Those shareholders who did not wish an exit from their holding of capital were permitted to exercise an option to that effect. The resolution

then provided that if the share holding of those shareholders who assented or did not object to the proposed reduction of capital exceeded 25% of the total issued and paid up capital, priority would be given to the small shareholders of the Company. In such a situation, the shareholding of shareholders holding the least number of shares would be extinguished and their capital would be returned first, starting from the shareholder holding the least number of shares until 25% of issued and paid up share capital offered was returned. For the purposes of these proceedings it is not necessary for the Court to enter into a wider question as to whether it will be open to a Company, in law, to regard abstaining shareholders as having voted in favour of the scheme. For the purposes of of the present case, it would be appropriate for the Court to proceed on the basis that a shareholder who did not cast his ballot either in favour of or against the scheme, must be regarded as having abstained from the scheme. In the present case, it has not been disputed before the Court by any of the Counsel that the votes of those shareholders who abstained from casting their ballots in support of the scheme, are not required to be taken into account in determining whether the resolution was

passed by the requisite statutory majority. Indeed it would be appropriate to treat those shareholders who did not cast their votes one way or the other as persons who had abstained from voting at the meeting. But these abstentions as the common course of events would show, are normal instances of Company meetings. That is why, Section 185 of the Companies' Act, 1956 provides that a resolution will be regarded as an ordinary resolution when at the general meeting the votes in favour of the resolution by members who are deemed to be entitled so to do vote in person or by proxies exceeds the votes if any, cast against the resolution by members entitled to voting. Similarly under sub-section (2) of Section 189 a special resolution is where votes cast in favour of the resolution by members who being entitled to so to do vote in person or proxies are not less than three times the number of votes cast against the resolution by members so entitled and voting. The touch stone laid down by the statute is votes by persons who are entitled to vote and who in fact cast their votes at the meeting. The fact that some shareholders may decide to abstain from the meeting will not dilute the efficacy of the resolution, general or special, provided the requisite

statutory majority is found to exist at the conclusion of the poll. In the present case, there are two aspects to the resolution proposed by the Company which are as follows: (i) An affirmative or negative vote in respect of the resolution proposing reduction and (ii) An objection to giving up one's shares in the proposed reduction thereby dealing with the mechanism of the reduction. In the present case, both these facets are covered by the same resolution. 3723 shareholders who did not object to the scheme by casting their votes are not counted towards the votes required to approve the decision to reduce per se. In other words, the assumption made on account of abstention in respect of the persons who did not vote is only in respect of the mechanism of reduction. This is, therefore, not a case where the Company has assumed that such persons who abstained from voting were in favour of the resolution that was resolved per se. Consequently, the question as to whether such abstention can be assumed to be in favour of the resolution will not arise in the facts of this case.

17. Having considered the petition of the Stock Exchange, it is

not possible for the Court to come to the conclusion that the exit opportunity that was offered was inequitable or unjust. The material placed on the record provides data of the share price movements. The price of Rs.183/- per share was well above the price at which the shares of the Company were traded on the date on which a resolution was passed by the Board of Directors. In fact, as the Company has pointed out to the Court, the price per share as offered was higher than the price prevalent on the date on which the result of the postal ballot was declared as well as on the date on which a draft petition was filed before the Stock Exchange for its approval. The speculative variation in the price of the shares of the Company will not operate, as suggested, to invalidate a resolution which has been validly passed. None of the shareholders have objected to the proposed reduction.

18. In the circumstances, there is no reason why the prayer for reduction should not be allowed. However, before proceeding to do so, it would be appropriate for the Court to clarify that the orders passed in this petition, shall not preclude the Bombay Stock Exchange and the Pune Stock Exchange from taking recourse to their

rights on the question as to whether there has been any violation of the listing agreement either with reference to the provision of clause 24(f) or otherwise. The Stock Exchanges would be at liberty to take recourse to such powers as are conferred upon them in accordance with law. Subject to the aforesaid, the Company Petition is made absolute in terms of prayer clauses (a) to (d).

.....